SYMBIOSIS INTERNATIONAL UNIVERSITY

PUNE

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Research Proposal for submission to Doctoral Committee

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Signature of Student

I have gone through the enclosed research proposal and approve its submission to the Doctoral Committee for further approval.

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Signature of guide

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Impact of ownership patterns on performance of firms in India in relation to firm life cycle stages.

Introduction:

Ownership patterns and structures have been defined extensively across the world in management literature; famous amongst them being the classical work of Berle and Means in the book "The Modern Corporation and Private Property" (1932). The growing concentration of industry and the separation of ownership from control were well documented in this classic work. The question that remained in the minds of the financial analyst was "why an entrepreneur or manager of a firm would choose a set of activities for the firm such that the total value of the firm is less than what it would be, had he been the sole owner of the firm. These questions find their answers in the agency theory and its various implications which were extensively dealt with in various works.

Contrary theories to the Agency theory such as the stewardship theory give alternate explanations. A number of researches also prove that neither the agency nor the stewardship theory hold good to explain firm performance. In India, we see the movement in ownership of major business ownerships from closely held family owned business houses towards family owned but professionally managed and also owned by foreign direct investors. There is also another major category of firms which are government owned.

Large numbers of researches have been carried out in the United States beginning from 1920 on the separation of ownership from control and its impact on firm performance and profitability. The study on the agency theory grew in prominence with the works of Fama and Jensen (1983). The Agency theory propounds that separation of ownership from management leads to a differentiation in the motives of managers and owners. While the owner would be more interested in maximising return through dividends, the manager would focus on reinvestment of profits and maximisation of returns in the forms of salaries, perks etc.

In India however comparatively very few studies have been made on the emerging forms of ownership patterns and its impact on firm performance. A study on the BSE 500 on the effect of insider ownership on share value yielded results that the relationship is non linear in nature. This is in support of the Agency theory. (Pant et al, 2007)

This study aims at arriving at a model which will define the ownership pattern to be maintained over the different firm life cycle stages in order to maximise firm performance and return on assets in the Indian scenario. The study will be performed on a set of panel data of the BSE 500 companies for a five year period which has a fair representation of body corporates across industries in India.

Such a model when offered to the industry will help top management take an informed decision on bringing about changes in ownership patterns for the betterment of firm performance and asset utilisation, ultimately bettering share value.

The study gains further importance in light of a surge in mergers and acquisitions in the Indian scenario. It shall also contribute to provide an empirical solution to areas of dispute such as allowing or disallowing foreign direct investment in the retail sector. A well proven model offering solutions on the ownership pattern that will best impact the firm profitability given the stage of growth the corporate is in can help the government, lenders and investors take informed decisions on divesture, approval of amalgamations and allowing fund inflow for capital expansion through External Commercial Borrowings.

Review of literature:

The agency theory draws from the definition of an agency relationship wherein there is an existing contract under which one or more persons engage another person (the agent) to perform some service on their behalf which involves the authority to make decisions. If both the parties intend to maximize returns to themselves out of the contract, the agent would not always act in the best interest of the principal. There is also a monitoring cost incurred by the principal in addition to the bonding cost incurred to maintain the agency relationship. The definition of agency costs was brought out by Jensen and Mecking (1976) in their landmark paper Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. Conclusions drawn by extending the agency theory include increase in the levels of expropriation of minority shareholders rights, poor share holder protection leading to erosion of firm value. (La Porta et al, 1999). It has been found that family held firms are more prone to undertake investments with a positive net present value and thereby increase their stake in the firm in order to take advantage of these investments. (Julio Pindado et al, 2008).

The impact of founding family ownership on the performance of companies when examined, yields various results. One branch identifies that block ownership of shares mitigates the conflict of interest between Managers and shareholders. (Dodd and Warner, 1983). Another branch identifies that high ownership and control can erode the value of shares for minority share holders and lead to a negative impact on the firm performance. (Morck et al, 1988). A third view point states that the firms performance improves at low levels of block ownership on account of efficient monitoring by the block holders but declines at higher levels of block ownership on account of increasing conflict between large shareholders and minority investors. Within block ownerships, it has been identified that the identity of the block owner is also relevant in determining firm performance levels. Companies, whose block owners are

financial institutions or foreign investors, tend to show higher levels of performance when compared with other investor categories (Nicholas Boone, 2011).

A research performed on the ownership patterns in the Italian Wine business yielded results that there exists a positive relationship between family power and revenue trend. However there exists an inverted U relationship between family power and firm profitability. (Carmen Gallucci et al, 2013). Further studies on firms in Taiwan yielded results that profitability of a firm increases with increase in levels of family ownership. However the relationship between family ownership and profitability takes a U shaped curve beyond the peak of approximately 30% family ownership. (Jonchi Shyu, 2011).

On the contrary, the Stewardship theory provides an alternate explanation. The stewardship theory has its foundations from the definition of a relationship on trust. Mayer et al (1995) in their paper titled *An Integrative Model of Organizational trust* state that trust is a function of ability, benevolence and integrity. One does not need to risk anything in order to trust; However, one must take a risk in order to engage in trusting action. Trust will lead to risk taking in a relationship, and the form of the risk taking depends on the situation. For example, a supervisor may take a risk by allowing an employee to handle an important account rather than handling it personally. The supervisor risks repercussions if the employee mishandles the account. Separation of ownership from control would therefore lead to better performance if the appointment of the agent is based on the three pillars of trust as defined above.

A study on board composition and firm performance carried out on non financial listed firms in Malaysia showed that when the proportion of independent outside directors is greater or equal to 50% of the board strength, this has a positive impact on firm performance. (Rashid Ameer et al, 2010)

It is interesting to note that in spite of numerous theories expounded to explain firm structures and firm theory, the firm continues to remain a “Black box” and the theories rather explain

the markets in which the firm operates. This “black box” theory was also identified by Adam Smith and Alfred Marshall in their well known works on economics. The various issues associated with separation of ownership and control in the modern corporation is intimately associated with the problem of agency.

There are contradictory views on the ownership patterns of the modern corporation in various works of literature around the world. A study on corporate ownership around the world across 27 wealthy nations by La Porta et al (1999) showed that there is significant concentration of ownership and firms are typically controlled by families or the state. Works by Demsetz and Lehn (1985) and Shleifer and Vishny (1986) have found that there is concentration of ownership even amongst large firms in the United States of America. In the Indian scenario, the presence of a family based governance system was examined with a non linear effect on firm value (Pant et al, 2007).

Although Agency theory attempts to explain the relation between the presence of the founding family on the board and the firm performance, the stewardship theory gives an alternate explanation. Outside members may be placed on the board in order to give industry specific advice and bring technical competence to the board. However founding family members may identify closely with the firm and view the firms health as an extension of their own well being (Gomez-Mejia,L arraza-Kintana, and Makri 2003, Davis, Schoorman and Donaldson, 1997). In response to the concern that firms managed by founding family members may be associated with lack of adequate corporate governance, a study by Dechun Wang (2006) on founding family ownership and its impact on earnings quality showed that Founding family ownership is associated with lower abnormal accruals, greater earnings informativeness, and less persistence of transitory loss components in earnings. In addition, the results suggest a nonlinear relation between family ownership and earnings quality.

The impact of foreign institutional investors and foreign corporate shareholders on the performance of firms using a multi theoretic approach was examined by Douma, George and Kabir (2006). The results show that foreign corporate positively affects firm performance whereas the impact of foreign institutional ownership on firm performance is not clear cut. Institutional owners and the percentage of corporate equity being held by them are increasing rapidly. In the US, institutional owner's holdings in corporations are so large that they find it difficult to move their holdings from one firm to another. This leaves them more involved in the decision making process of the firm they hold stake in. The impact of outside Institutional holdings on the Return on Equity (ROE) is significant and it has been found that firms with relatively heavy holdings by Institutional Investors report low debt capital ratios and high ROEs. Family owned businesses on the other hand seem to prefer funding through long term debts as they are more willing to accept the covenants imposed by creditors. (Chaganti and Damanpour, 1991)

While the independent directors are instrumental in alleviating conflicts between opposing share holder groups, the presence of founding family members on the board leads them to act as stewards of firm value. There has been a deep concern towards expropriation of share holder wealth and absence of corporate governance on account of presence of founding family members on the board of firms. Various researches have examined the impact of founding family members presence on overall profitability and firm value. Conflicting results have been arrived at. Work not favoring presence of founding family members on the board quote the agency theory and its effects on profitability and firm value in favour of their stand. Works which support the presence of founding family members are based on the stewardship theory further proved by empirical data. (Anderson and Reeb, 2004)

In contrast to all the three views mentioned above, a stream of researchers have given a fourth view that there is no relationship between board composition and firm performance. A

Meta analytic review of board composition showed that neither the agency theory nor the stewardship theories are supported while examining board composition and its impact on firm performance. (Dalton et al, 1998)

In spite of the above conflicting theories and views on the impact of ownership patterns and board structures, it must be noted that the top management's goals for the firm and risk taking propensities affect the capital structure which in turn has an impact on the firm profitability and firm growth rate. The composition of top management executives once again depends on the ownership pattern. (Barton and Gordon, 1988). Hence it is important to understand the corporate ownership pattern existing today and its movement over the recent years.

Scope:

Ownership structure is represented by FDI ownership, Government Ownership, Family ownership and Widely held. Family ownership would include ownership by a group of close associates as well.

Firm performance is given by financial parameters the key amongst them being the Tobins Q which is an indicator of firm value vis a vis market expectations and Return on Assets.

This research looks at critically analysing the agency theory and the stewardship theories in the Indian context. The panel data set proposed to be used is the companies listed on the Bombay stock exchange and forming a part of the BSE 500 as on the financial year end or every year of data extracted. The study will follow a statistical approach to collect data from authentic databases approved by the university – Prowess and capital line. The results shall further be verified through an event study of corporates which have undergone ownership changes over a time span of five years. A further qualitative research in the form of interviews of select top management of corporates featuring in the BSE 500 would yield an

added perspective to the top management's view on ownership patterns and its impact on firm performance.

Firm life cycle stage as defined by Chandler (1962) in which the firm is currently in, shall be identified using the four quantity factors (dividend payout ratio, sales growth rate, capital expenditure and firm age) as suggested by Anthony and Ramesh (1992). The concentration shall be more on firms in the growth and maturity stages.

The study however does not include the intervening effect of policy changes or governmental changes on the firm performance. It also does not include changes in market conditions of the product demand resulting in changes in firm performance.

Problem statement:-

i. Is there a significant difference in firm performance for different patterns of ownership in the Indian corporate scenario?

ii. If such a difference exists, which pattern of ownership yields optimal results on firm performance?

iii. Does the pattern of ownership yielding optimal results on firm performance change according to the firm life cycle stage?

iv. Can the quantum of change in firm performance be predicted, given the nature of change in ownership pattern and the current firm life cycle stage?

v. Is there a significant difference in effiiciency in managing assets to generate earnings for different patterns of ownership in the Indian corporate scenario?

vi. If such a difference exists, which pattern of ownership yields best results on such efficiency in generating earnings out of assets?

Objectives of the study:-

i. To identify if there is a significant difference in firm performance for different patterns of ownership in the Indian scenario.

ii. To identify the pattern of ownership that optimises performance.

iii. To identify if there is a significant difference in asset efficiency for different patterns of ownership in the Indian scenario.

iv. To identify the pattern of ownership which optimises asset efficiency.

v. To arrive at a model which will define the ownership pattern to be maintained over the different firm life cycle stages of a body corporate in order to maximise firm performance in the Indian scenario.

Hypotheses:-

H_0: There is no significant difference in firm performance for different ownership patterns.

H_0: There is no significant difference in asset efficiency for different ownership patterns.

H_0: There is no effect of firm life cycle stage while examining the impact of ownership pattern on firm performance.

Methodology, Tools and techniques:

The study would use a panel dataset on companies in the BSE 500 Index. The BSE is India's oldest stock exchange and has provided an efficient capital raising platform for Indian corporates over the past 139 years. More than 5000 companies are listed on BSE making it world's No. 1 exchange in terms of listed members. The panel dataset would comprise of data over 5 years 2010 to 2015 of the companies listed on the S&P BSE 500 Index. The data on ownership pattern, firm performance, Firm Life cycle stage, events would be gathered from Prowess, ACE Knowledge Portal and the capitaline databases as approved by the university.

As regards the dependant variables, two accounting measures are proposed to be used: The Tobins Q to represent firm performance and the ROA (Return on Assets) to measure efficiency in managing assets to generate earnings.

As for the independant variable, ownership pattern shall be defined as FDI ownership, FII Ownership, Government Ownership, Family ownership and Widely held. Family ownership would include ownership by a group of close associates as well.

The firm life cycle stage as defined by Anthony and Ramesh (1992) is proposed to be used. The model takes into account dividend payout ratio, sales growth rate, capital expenditure and firm age to classify companies into the Growth stage, Mature stage and Stagnant stage.

Control variables would include firm size represented by the total assets, firm age represented by the number of years from business start up, financial leverage represented by the debt equity ratio and industry as defined by the standards of industry codes.

The main independant variable (Ownership structure) and some of the control variables are time variant. Hence, an appropriate statistical tool shall be applied such that the dataset is pooled and captured with time effects.

Schedule of the proposed work:

Broad Area	Specific Area to be covered	Days estimated
Review of literature	Reviewing extant literature on Ownership pattern theories Firm Life cycle theories Agency and Stewardship theories Indian literature on ownership patterns and impact on firm performance Latest journal writings on topic	90 (on going) 30 30
Data collection	Extracting data on ownership patterns across 5 year time span for BSE 500 and classifying them into buckets	20

	Extracting data on firm life cycles using market share for each firm since inception and classifying periods of life cycle for each firm	60
	Extracting data on firm performance and asset efficiency across 5 year span for BSE 500	20
Data Analysis	Choosing the most appropriate regression method by examining the data behaviour. Identifying and investigating into outliers. Data correction and elimination of missing datasets.	50
Model building	Proposing an initial model to test firm performance for different ownership patterns. Testing the model with different time lines. Releasing a paper for peer review in International journal.	90
Rework the gaps	Identify gaps in model through peer review and guide support. Improve upon the same and retest with data from alternate database such as NIFTY.	120
Eventy analysis (Qualitative research)	Analyse events leading to ownership pattern changes and board changes to predict performance changes to substantiate above results through empirical analysis.	60
Interviews	Structured Interviews with board member in select BSE 500 firms to gain top management perspective. Tabulating the results.	30
Analysing results of qualitative research`	Recording results of event analysis combined with structured interview responses. Publishing the same for peer review and guide review.	40

Rework the gaps	Identify gaps in the qualitative analysis and rectify the same	40
Conclusion	Documentation and reporting of findings	60
Estimated Total Number of days		**740**

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